Globalization, corporate finance, and coordinated capitalism: pension finance in Germany and Japan

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Globalization, Corporate Finance, and Coordinated Capitalism: Pension Finance in Germany and Japan*

by Philip Manow

Abstract
This paper analyzes 'globalization' as the interplay between domestic and 'foreign' economic agents that seek to break up nationally contained and/or institutionally constrained markets with the aim of altering distributive outcomes in their favor. I take as my exemplary cases the recent opening up of the Japanese and German pension markets. US-Japan trade negotiations and European market integration provide foreign competitors with entry into the pension market and increasingly allow domestic firms to exit the national 'regulatory regime'. The internationalization of the market for investment capital has made 'regime exit' more attractive for many German and Japanese firms while the international convergence of transparency rules and accounting standards are increasingly overhauling specific national business practices.

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1 Introduction

Financial markets today are certainly the most internationalized of all markets (Simmons 1998; Garrett 2000). It is here where globalization is most advanced. Today the level of capital market integration has clearly surpassed the level prevalent in the early heydays of 'globalization,' which reached its first peak in 1914 (cf. Maddison 1991), while international trade has only recently become as international as it once was in the first decade of the twentieth century.

Japan and Germany, as the two most successful export nations of the world, were and still are the foremost beneficiaries of the liberal postwar trade regime, yet their trade performance seems to have been based to a considerable degree on national financial systems that were not particular liberal in appearance. Japan's and Germany's financial markets were for a long time during the postwar period 'nationally contained' and/or institutionally constrained markets with state-regulation of revenue, public control of investment flows, financial targeting, an important role of the public sector in savings and banking (postal savings, public saving banks, and saving and loan cooperatives), and a rich legal and institutional framework that made capital more patient than the 'rest- and reckless' capital in the Anglo-American variant of capitalism (cf. Zysman 1983; Shonfield 1965; Ziegler 2000). Both in Germany and Japan, capital tends to be less 'liquid,' investments are of a long-term nature rather than oriented toward the highest revenue to be realized in the shortest period of time. Stable cross-shareholding (cf. Wenger/Kaserer 1998: 505, Table 1) [1] underpins strategic alliances between firms and between firms and banks, so that hostile takeovers were almost unheard-of events both in Germany and in Japan until recently (for Germany see Prigge 1998: 992, Table 25). Private households show a relatively high propensity to save and hold their savings predominantly in the form of bank deposits, while private shareholding has only recently become more prominent in both countries. The Japanese main bank system and the German *Hausbank* system gave business access to these relatively patient and 'modest,' that is low-revenue expecting, household savings. It thus buffered managers from shareholder control and allowed firms to strategically enter into new markets and invest into new technologies with a long-term perspective (cf. Aoki/Patrick 1994; Baums 1994; Sheard 1994). In this respect, the financial systems of Germany and Japan clearly diverge from the model of equity based corporate finance in which the stock market figures as the prime source of investment capital - the model prevalent in the UK and the US. In fact, one of the most often mentioned differences between the liberal Anglo-American and the non-liberal German and Japanese market economies is that, in the former model, stock markets are at the center of corporate finance (equity finance; 'outsider system,' 'external control'), while the latter model can be characterized as bank-based systems (debt finance; 'insider system,' 'internalized monitoring'; Kaplan 1997; Franks/Mayer 1997; Hopt et al. 1998).

The recent liberalization of *capital markets* and the changes in corporate finance that are associated with it can therefore be expected to be much less advantageous for the world's two leading export nations than has been the postwar liberalization of *goods markets*. Financial globalization threatens to undermine a crucial element of both the Japanese and German political economy: the stable long-term relations between lender and borrower of investment capital, and subsequently, the practices of long-term economic coordination between managers and workers *in so far as these practices* critically depend upon 'revenue-satisficing' behavior rather than the revenue-maximizing behavior of capital. Central for the long-term economic coordination in Germany and Japan was the *quid-pro-quo* of workers' wage restraint given in exchange for employers' credible commitment to reinvest the major part of the profits into the company, instead of paying out high dividends to the company's (share-)owners. This 'cooperative' outcome of the capital/labor game (Eichengreen 1994; Lancaster 1973) led in the long run to high productivity growth (due to high investments), low inflation (due to wage moderation), good export performance (due to the combination of high productivity and low inflation), rising real wages and increasing employment, and brought about what in Germany has been called *Mengenkonjunktur* and what in Japan analogously has been dubbed *boom in volume* (Hamada/Kasuya 1993: 177). Since the mid-1970s, however, the traditional manufacturing sectors have grown far less quickly and have even stagnated in terms of employment. Given this, the 'taming' of investment capital that was once a particular advantage of the German and Japanese political economies appears nowadays to have turned into a liability: taming has turned into 'trapping'. If in the future German and Japanese firms, in case they need to borrow money on an increasingly internationalized capital market, will have to promise to reward capital with the same short-term, high 'rate of return' that is guaranteed by their US-American competitors, the cooperative equilibrium of the capital/labor game comes under strong pressure. Where low 'instantaneous' revenue from investments does not translate anymore automatically into high growth rates over the long run, investors become more interested in maximizing their short-term profit. They therefore become increasingly critical of all the institutional impediments for 'quick in/quick out' types of investments, that is they become critical of exactly those institutional features of the German and Japanese political economy that were central in the old equilibrium for credibly committing capital to the cooperative strategy in the capital/labor coordination-game. Thus, while the old comparative advantages of their non-liberal orders diminish, the disadvantages (efficiency loss) that had always been tolerated are perceived as less and less acceptable, and indeed today have become much costlier.

The cooperative equilibrium of the capital/labor game has produced particularly salient 'efficiency losses' in the German and Japanese pension systems since in both countries the pension systems were used to stabilize inherited practices of economic coordination, to safeguard trustful employment relations, and to provide firms with patient capital, at the expense of the financial solidity and long-term viability of the pension systems themselves. Yet, the pension systems in Germany and Japan have each been thrown into severe crisis by

- the poor return from 'politically' motivated investments of Japanese pension capital or from company pension 'book reserves' of German firms,
- the growing labor costs due to generous 'defined benefit' promises of German and Japanese employers in the past,
- the massive use of early retirement provisions that allow German firms to adjust inexpensively and 'peacefully' to a more unfavorable economic environment,
- and last but not least, the demographic consequences of an economic model that has produced a distinctively gendered segmentation of the labor market and gendered patterns of skill acquisition, and that has led the two political economies into a 'low fertility equilibrium' (Esping-Andersen 1999: 67-70).

According to OECD estimates, the future liabilities of the German and Japanese pension system amount to 200 or even 300 percent of GDP by 2030 (see Table 1). This contrasts with the much better prospects for British and US-American pension systems.

Table 1: OECD estimates of financial liabilities of public pension programs (Germany, Japan, the UK, and the USA)

	Public pension payments % of GDP		Net financial liabilities in % of GDP		Increase in tax/GDP ratio to keep net debt constant	
	1995	**2030**	**1995**	**2030**	**2005**	**2030**
Germany	11.1	16.5	44	216	2.8	9.7
Japan	6.6	13.4	11	317	3.5	9.6
UK	4.5	5.5	40	137	1.7	3.5
US	4.1	6.6	51	95	-0.3	5.3
Source: Disney (2000: 4); also see Tanzi/Schuknecht (2000).						

It is therefore no surprise that the apparent superiority of the Anglo-American model of *corporate finance* plays a prominent role in the domestic German and Japanese reform discussions triggered by the changes in the cost/benefit ratio of their established economic orders. And it is indeed here where the liberal systems seem to outperform the coordinated political economies most clearly. US-American fund managers ridicule the poor performance of Japanese investment firms and pension funds, and Germany until recently was a conspicuous laggard with respect to the establishment of an 'equity culture' and to managers' regard for shareholder value. Not surprisingly, the superior performance of the American model of financial capitalism has often been used as a lever against Japanese and German ways 'to do (and finance) business.' In the US-Japan trade negotiations, the United States has pressed for the opening up of the huge Japanese pension fund market while German multinationals are increasingly forced to respond to the profit requests of powerful institutional investors, prominent among them being US-American pension funds. Moreover, German banks and insurance companies are being increasingly challenged by their European competitors who have been much longer active in the private pension business under a much more liberal regulative regime - a regime that is now being extended through the 'harmonization' of the European market. Both German and Japanese multinationals have to employ more and more the accounting standards and transparency rules proscribed by the US-American Financial Accounting Standards Board (FASB) or the International Accounting Standards Committee (IASC) if they want to avoid paying a risk premium for their access to the international capital market (Clark et al. 2000, 2000a). These standards clearly discriminate against the nonfunded or underfunded, defined benefit corporate pension schemes prevalent in Germany and Japan that have been used extensively in both countries for enhancing human capital and personnel management, specifically as a means to instigate investments into firm-specific skills and to secure low job turnover. Yet, "global markets may not appreciate these virtues when 'pricing' German [or Japanese] firms" (Clark et al. 2000a: 2, my addition). By assigning all investment risks to the firm, defined benefit schemes are perceived as less transparent than defined contribution schemes, which by definition cannot run into a deficit. [2] To the contrary, defined contribution plans "shift costs and financial risks to plan participants away from firm stockholders and management" (Clark et al. 2000: 7). To this come the increasing costs of administering DB pension plans. New US-American accounting standards like the FASB statement 87 have been associated with a trend in the US-pension market away from DB-schemes and toward DC-schemes. The same can be expected to occur in Germany and Japan with the spread of these 'generally accepted practices' to these countries. To uphold the established practices of worker/management cooperation - underpinned by workers' stable expectations about future income and by generational fairness between different cohorts of workers of a firm (see below) - has thus become much costlier, in fact too costly for many firms.

Yet, the spread of Anglo-American 'best practice' in corporate finance is a process not only suffered, but often also endorsed by domestic German and Japanese actors, who have become increasingly upset with poor revenue from their investments, with restricted access to venture capital, with the meager performance of pension funds or the almost total absence of a private pension market. Especially private banks and insurance companies worry about their comparative disadvantages vis-a-vis their Anglo-American competitors due to the multiple restrictions and market distortions they have to face in their home markets. The changes in pension finance in Japan and Germany are thus prime examples for the fact that globalization is not simply an 'external economic threat' to an economy but often works through "transnational alliance building, in which domestic actors find allies abroad" to further their specific domestic interests (Ziegler 2000: 197).

Yet, if the Japanese and German welfare states in general and their pension systems in particular have crucially contributed to the long-term stability of economic coordination (cf. Manow 2000, 2001) while at the same time this economic side-function has undermined their long-term sustainability, we are led to ask whether the (financial) crises of the German and Japanese welfare states and the political responses triggered by them, combined with financial market liberalization, will have a significant impact on the long-established practices of economic coordination in both countries.

To answer this question, this paper will sketch the story of the 'rise and demise' of the production/protection nexus in Germany and Japan with a particular focus on the role that pension finance has played in corporate finance, [3] corporate governance, and industrial relations. I will describe some of the consequences for the German and Japanese pension systems following from the fact that they have been deeply *embedded* in and have 'functionally' *contributed to* economic coordination in both political economies. Thus, the paper shares an interest in exploring the systematic nexus between 'different variants of capitalism' and 'different worlds of welfare' with a number of recent contributions to the comparative political economy literature (Hall/Soskice 2000; Estevez-Abe et al. 1999; Mares 1997, 1997a, 2000; Iversen 2000; Huber/Stephens 2001; Swenson 1999, 2000; Ebbinghaus/Manow 2001; Manow 1997, 2000, 2001a).

The paper is organized as follows: Section 2 will briefly sketch the history of the postwar reconstruction of the German pension system and its impact on corporate finance and industrial relations. I will then describe how much the recent changes in the public and private pension system will challenge core features of the established model of German capitalism. Section 3 addresses the challenge to the Japanese model of corporate finance that is posed by the deregulation of the Japanese pension fund market. In particular, I will look at the interaction effects among the liberalization of the financial sector, reforms of pension fund regulation, and changes in corporate finance in Japan. Section 4 will give a short outlook on the 'life expectancy' of economic coordination *German* and *Japanese style* in a time of international capital markets.

2 Pension finance, corporate finance, economic coordination, and the German political economy

To provide the reader with a short account of the role that the private and public pension systems have played in the development of the German political economy, we have to briefly describe the early postwar period in which both public old-age insurance and company pensions were re-established. This period ended with the important 1957 pension reform.

The most pressing problem for the West German postwar government was to provide the 12 million refugees who arrived from the East between 1945 and 1955 with housing and employment. This was an especially problematic task since Allied bombing had caused enormous damage in many big German cities - while less so to the old industrial centers of the *Reich*. To handle the housing problem, massive government intervention seemed indispensable. Compared with Japan, Germany certainly did experience a more profound break with the etatist practices of the war economy and after the war came to embrace a basically liberal economic policy. Still, the German government in the early 1950s engaged in quite substantial economic steering in cooperation with industry and its well-established institutions of self-governance (see Shonfield 1965: 260; Adamsen 1981). The granting of special tax privileges to selected sectors of the economy became an important tool of economic policy and the government's least interventionist practice. Given the high level of taxation prevalent in postwar Germany, this strategy proved to be quite effective. [4] Especially the construction sector enjoyed special tax privileges as a support for the quick reconstruction of the large German cities.

The preferential tax treatment of investments in housing and 'basic industries,' in turn, hindered the German stock market from developing into the prime source for investment capital. This was because the government at the same time had restricted maximum revenue from stocks in order to make investment in government bonds, construction loans, or private saving more attractive (Giersch et al. 1994: 83-84). [5] Long-term interest rates were subject to state regulation, which limited interest on mortgage to 5 percent p.a. and interests on industrial bonds to 6.5 percent p.a.. Since rent control was perceived as absolutely indispensable given the extreme shortage of housing, the state sought to minimize the attractiveness of alternative investments. Yet, control of interest on industry bonds meant that "the emission of securities played no more than a marginal role for business finance" (Giersch et al. 1994: 83). Thus, business was in need of other sources of capital. Again, tax privileges were employed to alleviate the capital shortage.

Already the Tax Law Adjustment Acts of June 1948 and April 1949 had granted massive tax incentives for savings and investments. "In 1950 the total amount deducted from individual and corporate income tax according to para. 7 (a)-(e) Income Tax Law was about 0.9 billion DM, i.e. 4.2 percent of the aggregate gross income of all individual and corporate tax returns. Forty-eight percent of this amount was expenditure on repairing war-damaged equipment, and about 30 percent were housing loans. These numbers suggest that tax privileges had great importance for capital formation" (Giersch et al. 1994: 60-61; also see Adamsen 1981: 45-50). Thus, firms came to cover their capital needs mainly through bank credit (backed by private saving) or retained profits (Adamsen 1981: 45-50 and 257). [6] An important part of these tax privileges became the preferential treatment of company pension schemes (Kersten 1959; Kempkes 1964).

In order to compensate business for its restricted access to the capital market, the government allowed firms to hold private company pensions as book reserves, i.e. merely in form of an account position that reported a firm's financial commitment in this respect (cf. von Wartenburg 1992). Book reserves became a "means of recycling employer pension contributions as self-managed self-investment funds" (Clark et al. 2000: 22). Company pensions in the form of book reserves were subject to taxation only at the time of payment. The tax privilege thus was considerable (DB-Research 1999: 30; Bundesbank 2001), and in light of this it is not surprising that still today (1997) 56 percent of all company pensions are granted in the form of direct entitlements toward the firm covered by 'book reserves' (and not, for instance as in Japan, as payments of a firm on behalf of their employees to an insurance company that then later pays out pensions to the retired worker; DB-Research 1999: 14). Note that the whole arrangement not only benefited employers by providing them with a source of cheap and 'unmonitored' internal credit, but also provided workers with the assurance that profits would indeed be reinvested, thus leading to productivity growth that in the longer run could translate into real wage increases (cf. Eichengreen 1994). In effect, workers became quasi co-owners of a firm with an interest in the long-term profitability of investments. While company pensions as a fringe benefit for the core skilled (male) workforce increased average job tenure, made the acquisition of firm-specific skills in addition to the acquired industry-wide skills less risky for the individual worker (Estevez-Abe et al. 1999), and gave the German work councils a role in negotiating the 'social wage,' it also provided a rationale for wage moderation both at the firm- and the industry-level. Work councils, which in the German 'dual system' (see Thelen 1991) are prohibited from bargaining over wages, became interested in having the wages set in the collective bargaining between unions and employer associations leave enough room for a positive add-up on top of the sector wage in form of company pensions or other 'gratifications' paid by the individual firm (in contrast to wages, work councils *can* negotiate with management about these fringe benefits). Hence, work councils represented an important faction within the unions that had an interest in moderate *collective* wage demands. Data on wage drift in the 1950s and 1960s indicate that the wages set in collective bargaining were indeed moderate enough to leave maneuvering room at the level of the individual firm (Paque 1995: 25, Figure 1). Yet, granted in form of pension entitlements, these benefits were to be reinvested so as to increase future pension entitlements and real wage growth. That pensions were most often 'defined benefit' (and followed seniority) burdened employers with the entire investment risk and minimized problems of 'intergenerational justice' between different cohorts of workers. Company pensions established a "social contract between successive generations of company workers" (Clark et al. 2000: 22; Eichengreen 1994).

In the early period of economic recovery, tax-privileged capital retained for 'social purposes' accounted for around 75 percent of all business self-financing, and the share of self-financing varied according to industry between 50 and 90 percent of total investments (Kerstner 1959: 34). Where company welfare schemes historically had played a bigger role, in particular in the heavy industry of the Ruhr region, capital earmarked for company pensions amounted to almost 70 percent of total company capital (ibid.). Since these private pension schemes were far from mature in the 1950s and 1960s, and since the turnover, profits, and workforces of companies continued to grow quickly until the early 1970s, company pension schemes represented a particularly cheap source of internal credit that enabled rapid business expansion. Compared with retained profits (in the form of tax-privileged company pensions), the issuing of bonds as a means to finance new investments was clearly less attractive. Until the mid-1950s, a free market for bonds in West Germany virtually did not exist. The *Kapitalmarktförderungsgesetz* (Law for the Encouragement of the Capital Market) of 1952 had lifted the interest ceiling on bonds, but industrial bonds were still subject to discriminatory taxation unlike bonds issued by public authorities. Private savings and retained profit continued to benefit from tax exemptions as well. Moreover, private saving was to some degree inelastic, i.e., private households showed a high propensity to save despite relatively low interest rates. The lack of an easy access to the stock market for private households played a role in this respect, too.

With respect to the postwar shortage of investment capital, the *public pension insurance* could not be used like the way the capital of the Japanese Employee Pension System (EPS) was used by the Ministry of Finance's (MoF) trust fund bureau (see below). There were several reasons for this. Firstly, the 1948 currency reform had affected not only private savings and life insurance, but also the public pension system. For the second time since the great inflation of 1922/23, the German old-age insurance had lost almost all of its financial assets. [7] Secondly, even when the old-age insurance started again to accumulate capital in 1949, the investment of pension capital in stock or the provision of credit to firms was legally prohibited, let alone a political use of pension capital to support strategic sectors of the economy or for investments into the public infrastructure like in Japan. The investment of pension fund capital had been heavily regulated by the state ever since the establishment of the public schemes in the 1880s. Painful experiences made during the crash of the early 1870s (*Gründerkrach*), which had led to the collapse and bankruptcy of many banks and workers mutual funds, had left their mark on the young Bismarckian welfare state. Investment of pension capital was restricted to supposedly secure, risk-free (however: low-revenue) investments (*mündelsichere Anlage* according to Articles 1807-1808 BGB [*Bürgerliches Gesetzbuch* - Civil Code]), that is to public bonds, loans to housing associations, and real estate. Investments into equities were illegal. [8]

After World War II, these provisions remained largely in place. [9] As a consequence, pension insurance capital in the 1950s was primarily invested in loans to housing cooperatives, in public bonds of the municipalities and the central government, and in normal bank deposits (BMA 1956, 1957, 1961). The capital assets of the social insurance schemes that were held in bank deposits, in turn, "greatly strengthen(ed) the ability of the banks to grant credit to their customers" in the early 1950s (Giersch et al. 1994) and thus underpinned the emerging stable bank-company relations that were to become so characteristic for the German political economy. Finally, the pension reform of 1957 changed the mode of pension financing from a fully funded system to a (modified) pay-as-you-go scheme. Thereafter, capital assets of the old-age insurance had the sole purpose to secure the basic liquidity of the system. The size of the legally mandated reserve that was to be held by the old-age insurance was reduced step by step, until in 1969 the reserve limit was set at no more than the equivalent of a one-month pension payment (*Drittes Rentenfinanzierungsänderungsgesetz*). This is why the overall volume of accumulated capital remained rather small (today between DM 20 and 30 billion, $10.75 and 16 billion) and why, given the concern for the short-term availability of the reserve, the capital could not be held in the form of equities.

The economic slowdown that began in the early 1970s, combined with stricter regulation of company pensions (since 1974), has rendered company pension schemes less and less attractive for business. In this context it is probably of less importance that the *Betriebsrentengesetz* (Company Pension Act 1974) and court rulings in the early and late 1980s forced employers to adjust pensions to inflation every three years, and restricted the employers' 'freedom of design' in questions of eligibility, [10] since these rulings made the pension promises not only more costly, but at the same time also more credible. The same holds true for stricter vesting rules introduced 1974. [11] Instead, firms had to reconsider the profitability of company pensions against the background of the growing maturity of these schemes and the changing age-composition of their workforce. Most importantly, with lower economic growth rates, industry wages set in collective bargaining tended to absorb an ever higher share of the productivity gains. Therefore the dualism between sectorwide wages negotiated between the employer association and the industrial union plus a top-up at the firm-level negotiated between the management and the work council proved less and less viable. Yet, this dualism had been so important for the combination of industry-wide vocational training plus the acquisition of firm specific skills through long job tenure (cf. Soskice et al. 1998; Estevez-Abe et al. 1999) upon which the German production model is based. While companies had enjoyed strictly positive returns from the establishment of company pension schemes in the early expansion period of the 1950s and 1960s, the cost/benefit ratio today is much less clear, if not outright negative. The coverage of company pensions decreased from 67 percent in 1981 to 61 percent in 1987 and has stabilized today around 64 percent with stagnant benefits.

What is true with respect to the diminishing wage drift, which in the past had allowed companies to provide their workers with additional welfare, holds also for the *public* pension insurance. The rising costs of the public scheme make it increasingly hard for companies to grant workers additional entitlements on a voluntary basis. Total social insurance contributions have risen from 26.5 percent of gross wages in 1970 to over 40 percent in the early 1990s. The contribution rate to the public pension scheme alone was first raised in a sequence of rapid contribution hikes between 1968 and 1973 from 14 percent to 18 percent. It was then raised to more than 20 percent in the 1990s in the wake of Germany's unification crisis. Thus, contributions to the public pension scheme account for more than half of the excessive burden put on wages by the German welfare state. [12] As a consequence and contrary to the proclaimed will of the government to strengthen company pensions as the 'second pillar' of old-age insurance, public pensions have become ever more important in recent years and increasingly crowd out the private schemes. Today, 89 percent of male employees and 70 percent of female employees in West Germany will receive a public pension at old age. For the coming cohorts, this share will further increase (to 95 percent and 94 percent respectively). In the former East Germany, already almost 100 percent of the workforce will receive a public pension (VDR 1999). Yet, only 36 percent of all male employees in West Germany and only 9 percent of all female employees receive a company pension at retirement. In East Germany, figures are even lower (4 and 2 percent, respectively). Entitlements differ considerably in their level as well. The average private pension benefit for a male employee (DM 632 per month) is more than twice as high as for a female employee (DM 302 as of 1996). However, both figures are inflated since they include retirement payments to the middle and upper management. Even though public pensions became more important 'in scope and scale' (i.e., with respect to coverage and entitlement levels) than the private schemes, company pensions today still play an important role for corporate *finance*. The continuing importance of company pensions for corporate finance may be demonstrated by the following numbers: Between 1980 and 1990, German firms issued new equity valued at a total of DM 126.1 billion. This is roughly comparable with company financing by means of pension reserves, which increased during the same period by about DM 120 billion (Hauck 1994: 556; for similar data for the time period 1982 - 1993, see DB-Research 1999: 1). Total book reserves earmarked for company pensions in 1994 were equivalent to 33 percent of the stock market value of all listed domestic firms. Pension reserves still amount to 10 percent of the balance sheet total of German firms or to DM 240 billion in 1990. They amount to around 50 percent of all company capital of German firms (DB-Research 1999: 7). The easy access to cheap internal capital thus remained important to companies beyond early postwar years of rapid economic growth and capital scarcity.

Voluntary private social expenditures are marginal compared to the statutory programs and are very likely to remain so in the future. Company pensions contribute 5 percent to the old-age income of a German worker, while they contribute about 25 percent in the United Kingdom (DB-Research 1999: 9 and 15). The different public/private mixes in Germany, on the one hand, and in the US and UK, on the other (comparable data on Japan were not available), are shown in Table 2.

Table 2: Social expenditure indicators 1993-1995, as a percentage of GDP

	Germany		UK		US	
	1993	**1995**	**1993**	**1995**	**1993**	**1995**
Public social expenditure	**23.0**	**23.1**	**19.6**	**19.3**	**15.8**	**16.1**
Mandatory private social expenditure	0.9	0.9	0.2	0.3	0.5	0.5
Voluntary private social expenditure	**0.7**	**0.7**	**2.8**	**3.1**	**7.2**	**7.1**
Total social expenditure	24.6	24.7	22.6	22.7	23.5	23.7
Source: OECD, SOXCs Data set.						

With the decreasing attractiveness of company pensions as a source of internal credit and with the increasing costs of the statutory schemes, many firms feel 'trapped' in a system that they once perceived as especially advantageous. Particularly small and medium enterprises are upset with the status quo since they are much less able to make efficient use of the multiple pathways into early retirement that the German public pension insurance so generously provides and that enables firms to downsize and rejuvenate their workforce without risking much shop-floor unrest. Smaller firms are much more dependent on older workers with their skills and their experience, and they are less able to use early retirement as an instrument of personnel policy (Mares 1997). Hence, a growing number of firms think they would be better off if they could link wages and welfare benefits more tightly to the firm's economic performance and thus opt out of an industrial relation- and production-system crucially based upon sectorwide economic coordination. Their interests coincide with those of German banks and big insurance companies who have realized that old-age insurance has an enormous market potential if only the encompassing and generous public scheme would allow more room for private initiative. German banks and the insurance industry increasingly perceive the broad coverage and relative generosity of public pensions as 'foregone profit' and as a main factor for their comparative disadvantage relative to their Dutch, British, or Irish competitors who have long been active in the pension fund business and thus have acquired much more experience. In this context, European market integration is of crucial importance, in particular since the Capital Liberalization Directive will contribute to a further 'de-nationalization' of the life-insurance and private pension market in the coming years, and will lead - if not to the harmonization of tax rules - at least to a uniform regulation of investments, portability, and vesting (cf. FT 12/11/1998, p. 4; Davis 1995: 262-265; EU-Greenbook 1997). This most prominently includes uniform 'prudent man' investment standards, which measured against the restrictive German practice will bring about a significant liberalization. For instance, German regulations stipulate that mutual insurances (*Pensionskassen*) can hold no more than 35 percent of their total assets in equities. In fact, in 1998 only 9 percent of their totals assets were domestic or foreign equities, whereas the percentage for British pension funds that operate under much more liberal rules was 75 percent of total capital (DB-Research 1999: 12 and 20). The European Commission aims to replace the restrictive German *quantitative* rules with the much more flexible *qualitative* 'rules of prudence' under which British or Dutch pension funds are allowed to operate. Moreover, the European Commission has also announced that it is preparing a proposal "requiring all EU listed companies to prepare their consolidated accounts in accordance with ... International Accounting Standards" (quoted from Clark et al. 2000: 6). IAS will be binding for all European listed companies from 2005 on (FAZ 14.2.2001). Since 1998, German firms have been allowed to use FASB or IASC standards, and larger firms have been very quick in adopting these standards even though the majority of them are still not listed on either the London or New York stock exchange (Clark et al. 2000: 16). Yet, these standards provide firms with strong incentives to switch from defined benefit plans to defined contribution plans despite the fact that defined contribution plans cannot provide workers with the kind of benefit predictability and benefit equality so critical for the functioning of long-term economic coordination. [13]

Thus, German banks and insurance companies perceive the crisis of the public scheme as an opportunity to gain market shares in the promising new market of private pensions. The recent pension reform, which will introduce partial funding of pension entitlements for the first time since World War II and which will allow the establishment of pension funds (although these will not be fully designed along the line of the British or US-American model), proves that the government as well sees the funding and privatizing of pensions as a chance to fight the crisis of the public scheme and, at the same time, to strengthen the domestic financial sector within the new European market. According to estimations, the 2001 pension reform will lead to the build-up of capital stock equaling DM 64 billion within the next six years. This is not an overly impressive figure if compared with the total volume of investment fund capital (DM 90 billion in 1999) or private life insurance (DM 110 billion in 1999; DB-Research 1999), yet the new pension capital will have a recognizable effect on the German stock market. Thus, the demographic pressures exerted on the German pay-as-you-go system are not the only factors prompting the government to seek to stimulate growth of private pensions as a substitute for social security. The crisis of the German public pension system coincides with the opening of the German insurance market under EU law (Capital Movements and Capital Liberalization Directive; cf. Rabe 1997) and the interest of powerful domestic economic players to move out of an 'equilibrium' that for most of the postwar period was based upon the 'institutional taming' of investment capital. The interplay between changed domestic constellations of interests and external pressures has already led to a visible erosion of Germany's stakeholder model of corporate governance (Ziegler 2000). The reform of the public pension system has to be understood in this context, in particular together with the recent reform of the tax code in which banks selling their holdings are exempted from paying taxes for the significant profits thus generated. Stable shareholding *German style* apparently has lost most of its charm. The reform of pension finance indicates that *Modell Deutschland* is currently undergoing fundamental, structural change. [14] Yet, the reform of coordinated capitalism - as we will see in the next section - appears to be even more profound in Japan.

3 Pension finance, corporate finance, economic coordination, and the Japanese political economy

Postwar Japan also practiced a sophisticated 'social control of consumption'. As in Germany, the Japanese government discriminated against consumption after the war while supporting investments into heavy industry and public infrastructure. High levels of private savings were channeled into 'strategic sectors,' key industries, and important infrastructure-projects, which had been pre-selected by the central bureaucracy. Interest rates were strictly controlled. Again like in Germany, these "controls created subsidies for priority sectors in the form of low interest rates, which in turn necessitated the control of bank deposit rates" (Uede 1999: 93). Interest rates on government bonds set the pattern for the rates on corporate bonds, and the former were held at artificially low levels. High rates of private saving, limited options to hold these savings, and the political usage of this capital helped provide business with inexpensive and relatively patient capital. This, in turn, was one of the crucial preconditions for the stability of a production regime that was critically based upon stable employment patterns, the acquisition of firm-specific skills, and the exchange between wage moderation and a high investment rate.

In postwar Japan, Postal Savings and Postal Life Insurance were the most important instruments by which the state fostered high private household saving rates and was able to siphon capital into strategic sectors of the economy. In the absence of well-developed social insurance programs in the 1950s, these were the few options for citizens who wanted to save for their old age. The capital of Postal Savings was (and still is) transferred to the Fiscal Investment and Loan program (FILP) under the administrative responsibility of the Ministry of Finance (MoF) and its trust fund bureau. The same is true for the capital of the Employee Pension System (Kosei Nenkin Hoken, KNH), which was originally founded in 1941 and re-established in the early 1950s. FILP is the important shadow budget of the Japanese government, roughly half as big as the official budget, but entirely beyond parliamentary control. Decisions over the FILP funds are the sole prerogative of the government, in particular of the MoF's trust fund bureau.

Yet, the increasing complaints by business about total government control over the capital that was levied from employers and employees by the Employee Pension System motivated the government in 1964 to establish Employee Pension Funds (Kosei Nenkin Kikin, KNK; starting in 1966). Employee Pension Funds offered firms the opportunity to contract out of the public scheme. Given the consent of the company union and given the fulfillment of certain requirements (e.g., 30 percent higher benefits than those paid by the Employee Pension System), a firm was allowed to *opt out* of EPS and to hand the company pension fund over to a life insurance company or trust bank (Watanabe 1998; Estienne 1999). A firm could opt out of the EPS but then had to *contract out* the pension fund to a life insurance company or trust bank. This means that, contrary to Germany, large firms were not allowed to run internal schemes (for instance, in the form of book reserves). [15]

This took into account unions' concerns about the potential misuse of company pensions as paternalistic devices to control and discipline workers. Especially, the contracting-out provision represented a credible commitment of employers to honor in the future the pension promises given at the time and it reduced the dependence of employees on employers in a labor market based on 'internal careers,' where exit and job switches were rare events. But the provision also served the MoF's goal to support the domestic life insurance industry and the banking sector.

The Japanese government had taken measures to support the life insurance industry even before 1964. In 1947, it had licensed life insurance companies to sell Group Insurance Plans; and in 1962, the government introduced Tax Qualified Corporate Pension Plans, which again only life insurance companies and trust banks were allowed to handle. Similar to German company pensions, Tax Qualified Pensions offered primarily small- and medium-sized firms an opportunity to inexpensively finance their investments out of retained profit. Thanks to these administrative measures, the Japanese life insurance industry grew rapidly and today is one of the largest in the world, while also being one of the least confronted with foreign competition (Estevez-Abe 2001: 11). [16] With 71 percent of premium income earned and 77 percent of assets held by the seven largest companies, the Japanese life insurance market is also "the most highly concentrated (…) among developed nations" (Probert 2001: 5).

However, government regulation of the emerging pension market did not only support the domestic life insurance industry. The government had also developed an interest in forestalling 'excessive competition' between firms for scarce labor in times of high growth and full employment through ever more generous company welfare schemes. Tight state regulation of pensions was supposed to help prevent intense 'welfare drift' from emerging. Firms had an interest in 'standardizing' careers based on long-term labor contracts. 'Employer hopping' or poaching among employers for scarce (skilled) labor was to be avoided. This meant also to standardize the welfare entitlements and to link them to seniority and job tenure. Thus, contracting out pensions did not mean that Japanese pensions were privatized or liberalized. Legislation had subjected the funds to tight and *uniform* regulation, including the pooling of funds and the stipulation of a uniform revenue rate for all out-contracted pension funds (the rate was set at 5.5 percent annually and remained at that level for almost thirty years; in April 1994 it was cut to 4.5 percent, then to 2.5 in April 1996 and finally to 1.5 percent in 2000; Probert 2001: 11, Fn. 19; see Estienne 1999, 1999a; Watanabe 1998). Later, the government also ordered the indexation of private pensions and strictly linked the EPF pensions to the movement of benefits in the public EPS pensions (Estienne 1999: 94). Moreover, the state regulation of the 'private' contracted out schemes secured that company welfare was more than a simple fringe benefit granted and withdrawn by employers at will, that it was more than a voluntary commitment that could be expected to be revoked in the next economic downturn. While especially large companies were able to stabilize their workforce by offering more favorable provisions as compared with the public schemes, the state continued to tightly regulate company welfare, forced uniform standards upon the larger part of the industry, and lent credibility to the promises of business. The state played the role of a "direct structurer and overseer of occupationally-linked pensions" (Shinkawa/Pempel 1997: 170; cf. Estienne 1999: 94).

Japan's dual industrial structure had been replicated in the dual structure of the Japanese welfare state. Once they had the opportunity, most large firms chose to opt out of the Employee Pension System, while workers in the many small- and medium sized firms usually remained in the EPS and/or enjoyed the preferential tax treatment of the Tax Qualified Pensions, while self-employed workers most often were members of the National

Pension System. Within this system, lower premiums, less co-payment, higher benefits prevailed in the statutory 'public' company schemes (EPS), and even more generous were the contracted-out company schemes in health and pension insurance (EPF), while residual provisions, lower benefits, and longer qualifying periods prevailed in the lower tier of the public pension and health program (National Pension System [NPS, 1959] and National Health Insurance [NHI, 1938/1958]; Estevez-Abe 1996; Estienne 1999). Government regulation of pension funds helped the standardization of company-based social benefits in very much the same way as Germany's public pension scheme did for German pattern wage bargaining. Yet, the out-contracted pension funds, which were based on the 'defined benefit'- and seniority-principle like German public pensions, established "*intra-company* inter-generational solidarity," whereas the German pension system established "society-wide inter-generational solidarity" (Estevez-Abe 1996: 9). Because this intra-firm solidarity was based on income redistribution from younger to older workers, "workers had an added incentive not to quit before they began receiving back their share of the contributions" (ibid.).

In this context it is important to distinguish between the *public provision* and the *public regulation* of social welfare, and it is often highlighted as a distinctive feature of the East Asian welfare regimes that they tend to put particular emphasis on regulation rather than provision (Jacobs 1998; Goodman et al. 1998). The common assumption that the private provision of social benefits automatically is proof of the liberal, 'commodifying' character of a welfare state regime (Esping-Andersen 1990; for Japan especially see Esping-Andersen 1997: 183) ignores this important difference and underestimates the degree to which 'private' but publicly regulated welfare schemes differ in their impact on the market from what would have been obtained as a pure market 'liberal' equilibrium. Although at a glance they resemble US-American welfare capitalism in many respects, Japan's 'private' company pension schemes differ profoundly, given the high degree of governmental regulation that secure similar entitlements across firms and industries. One indication for this is that the EPF pensions are inflation-indexed, 'defined benefit' schemes in contrast to 'defined contribution' schemes like the US-American 401(k) pensions. In a detailed assessment of the Japanese pension funds, Jean-Francois Estienne thus concludes that 'contracting out' in the case of the Kosei Nekin Kikin (EPF) appears "in a version quite different from the Anglo-American model, since there exist links between the private and the public schemes both in organizational terms and in terms of performance" (Estienne 1999: 94; my translation). Within the Japanese "welfare production regime" (Estevez-Abe et al. 1999), the Japanese welfare state came to underpin business coordination much more than purely voluntary schemes would have been able to do.

Again, as in the German case, pensions also helped firms get access to relatively patient capital. One of the initial motives for the introduction of Employee Pension Funds was to permit "employers to merge part of the corporate cost of retirement payments [with] the statutory pension programs, thereby reducing overall labor costs" (Estevez-Abe 2001: 17). The shift from lump-sum 'gratitude payments' financed out of a company's reserves toward pension funds contracted out to a life insurer or trust bank that took place in the mid-1960s was fostered by simultaneous changes in the tax system. While the tax exemptions for those capital reserves that were earmarked for retirement benefits were significantly reduced in the fiscal year 1962 (from 100 percent to 40 percent), the 1966 introduction of employee pension funds and the 1962 introduction of Tax Qualified Pensions made it more attractive for firms to provide income security for their retirees in these new ways, in particular since the contributions of employers and employees to both schemes were made fully tax deductible.

All this came together with a shift from individual to institutional shareholding that took place in the first half of the 1960s. This shift turned Japanese life insurance companies into major institutional investors and thus strongly supported the emergence of patient lender/borrower relationships in Japan. During the so-called 'securities recession' from 1961 to 1965, the Nikkei-index dropped at an annual rate of 14 percent after an unprecedented boom period during which it had risen annually at an impressive 29 percent from 1955 to 1961. Life insurers used the stock market recession to significantly increase their ownership of shares (from 7.88 percent in 1964 to nearly 11 percent in 1966). [17] Most importantly, life insurance companies became the largest shareholders of city banks and major local banks (see the data given in Estevez-Abe 1997: 14). The occupation forces had attempted to establish an 'equity democracy' by breaking up the old *Zaibatsu* and by supporting dispersed individual shareholding along the lines of the American model. Yet, during the *baisse* at the Tokyo stock market, the proportion of individual shareholding dropped from 46.68 percent in 1963 to only 42.36 percent in 1967. Individual share holding has been in constant decline since then and accounted for no more than 24 percent in 1994 and even fell to 18.9 percent in 1998 (Kanda 1998: 928, 930, Table 2; Suto 2000: 13, Table 2), while banks (22 percent) and life insurance companies (11 percent) today own 33 percent of all stock.

As an upshot of these developments, business relations between firms and life insurers became very close. Life insurance companies became "key players in (...) stable shareholding arrangements" (McKenzie 1992: 83) and an important source of 'patient,' 'modest,' 'silent' capital. While the life insurance companies themselves are mostly mutual corporations and thus cannot be direct partners in cross-shareholding arrangements, [18] pension contracts provided a functional equivalent to the 'mutual hostage-holding' between listed firms in the form of reciprocal shareholding (McKenzie 1992). Japanese pension fund sponsors allocated management business to trust banks and life insurance companies of their industrial group under the condition that the life insurer or trust bank, in turn, would buy shares of their company. Since competition in terms of performance between the life insurance companies was strongly restricted by the MoF (see below), and since market entry by new competitors was blocked as well - thus restricting the number of life insurers to no more than twenty companies until the 1980s - life insurers were responsive toward these demands (McKenzie 1992). This established long-term exchange relations in which the "life insurer becomes a stable shareholder in a company and in return the company has its employees buy pension schemes and group life insurance from this particular insurer" (Baums/Schaede 1994: 639; McKenzie 1992: 85 and 92; Estevez-Abe 1997; Komiya 1994: 382, Fn. 7; Suto 2000).

Given that the rate of return from pension funds was set at a moderate annual 5.5 percent for all funds, life insurers developed no particularly strong interest in the performance of their portfolios as long as this official target was met. Profits from the increased value of stocks were not passed on to policyholders, but were retained as latent earning (*fukumieki*; see Probert 2001: 1). The officially mandated rate of return allowed fund managers to pool just about all their pension fund assets, out of which all firms then received the same proportional return. The lack of transparency due to the pooling of assets meant that contracting firms lacked interest in the performance of their particular fund as well. This was also caused by the relatively young age of the workforce in the 1950s and 1960s, combined with the high growth rates during these years which made it easy to meet the officially set 'rate of return'-target. Competition between insurance companies and banks for the pension fund business in terms of performance was further restricted by the detailed regulation of pension fund investment (5:3:3:2 rule). [19] Hence, life insurance companies had no incentives to interfere much with a firm's management. They rather remained 'silent partners' and therefore became a major source of patient capital for industry. The pension fund business became part of the complex of 'total transactions' so characteristic for inter-company relations in the Japanese economic system. Given the tight state regulation of competition and performance, Japanese pension funds did not develop into aggressive institutional investors that pressed firms hard for a better rate of return. Only recently has performance become a matter of greater concern. Furthermore, as long as companies could count on a steady supply of patient and modest capital, hostile takeovers remained alien to the Japanese economy. This, in turn, helped make the private commitments of companies toward their labor force credible, since in the US-American mergers and acquisitions business, pension plans were often terminated after the merger, and pension fund assets "that remained after the satisfaction of all plan liabilities" were capitalized (Sass 1997: 283-84, Fn. 29). This asset-stripping endangers the long-term credibility of private pension promises even if pension entitlements of employees are vested after a relatively short period of time.

While the literature usually treats the Japanese and the US-American company pensions as similar cases of private welfare, and while the high share of private social spending is often said to justify a characterization of the Japanese social protection system as liberal and residual, both systems do indeed follow an entirely different logic, as the reconstruction of the incentive effects of the Japanese EPFs demonstrates. While Japanese pension capital underpins stable relations between borrower and lender of capital with life insurance companies and trust banks at the center of these stable relations, pension funds in the US are among the most prominent institutional investors pressing firms hard for an ever better rate of return. This supports the claim that in Japan as well as in the US "in many ways, the design of 'funded' welfare programs *shaped and was shaped* by the prevailing financial relations" (Estevez-Abe 1997: 8; emphasis added).

The importance of life insurance companies as major shareholders can be seen in Table 3. Although British life insurance companies hold a similar percentage of the total of stocks (see Table 3), one has to bear in mind that the number of firms in this sector is much smaller in Japan than in Great Britain due to the strict market-entry control performed by the MoF. Japanese banks held 26 percent of all common stocks in 1994, but there are more than eighty banks, but only twenty-five life insurance companies, of which sixteen account for most of the business. No more than twenty-one life insurance companies and seventeen trust banks managed the entire Japanese pension fund business, comprising nearly 1,900 funds with about 12.1 million people enrolled as of March 1996 (roughly 38 percent of the members of the EPS). The assets added up to 41.6 trillion Yen. While equities account only for 27 percent of the portfolio of Japanese pension fund, the oligopolistic structure of the industry concentrates economic power and influence in the hands of only a small number of firms. Compared to the British and American funds (see Table 3), "a meager 16 mutual life insurance companies are the most influential 'owners' of Japanese big business" (Komiya 1994: 366). At the same time, Japanese life insurance companies have become an important source for long-term credit. Since they are not only major shareholders, but also provide long-term credit (see the share of bonds and loans of total assets in Table 4), they have developed into central economic actors within the Japanese economic system. Growing takeover fears of listed Japanese firms have even increased the importance of life insurance companies as stable shareholders in the 1980s and 1990s (Komiya 1994: 382). [20]

Table 3: Ownership of common stock (percent at year end)

	Germany (1993)	Japan (FY 1994)	UK (1993)	US (1994)
1. Financial sector	29	44	62	45

1.1 Banks	**14**	**26**	1	3
1.2 Insurance companies	**7**	**16**	17	4
1.3 Investment funds	0	0	0	0
1.4 Pension funds	0	0	**34**	**26**
1.5 Mutual funds	8	0	7	12
2. Non-financial sector	72	56	39	55
2.1 Non-financial enterprises	39	24	2	0
2.2 Public authorities	4	1	1	0
2.3 Individuals	17	24	18	**48**
2.4 Foreign	12	7	16	6
Source: See below, Table 4				

Table 4: Portfolio composition of pension funds in the UK, US, Japan, and Germany

	Equities	**Bonds and loans**	**Property**	**Liquidity and deposits**	**Of which foreign assets**
UK	**80**	11	6	3	**30**
US	**48**	38	0	7	10
Germany	11	**75**	11	3	6
Japan	27	**61**	2	3	7
Source: Davis (1998: 97)					

Yet, this arrangement, which had been so beneficial for key economic actors in the first three postwar decades, came with costs. These became ever more visible in the 1980s and 1990s. The relatively poor rate of return from Japanese pension funds is the prime example for a potential long-run trade-off between the 'productivity of industry' and the 'profitability of investments' in a coordinated political economy. If the cooperative outcome of the capital/labor game is based upon the credible commitment that profits will remain 'within the firm' and will be reinvested (Eichengreen 1994), [21] this can 'trap' capital if investments in the traditional industrial sectors do not translate any more into high economic growth. In other words, the cooperative equilibrium proved advantageous during the initial period of catch-up, when rapid productivity increases in the key manufacturing sectors set the whole economy on a high growth path. However, the structural change from an industrial to a service economy and the rise of vibrant new industrial sectors like the software- and internet-industry are trends to which the German and Japanese coordinated economies have responded much less impressively.

The effects for pension finance are clearly visible today. That pension capital figured as a prime source of patient investment capital meant to sacrifice a good rate of return. Estimations hold that in 1994, 29 percent of all EP funds were underfunded on a book-value basis and 56 percent at market value (Davis 1995: 101). Sacrificing optimal performance of pension funds in a rapidly aging society like the Japanese necessarily leads into a financial crisis of the pension system. Poor performance was a result first of all of tight state regulation of investments: Unlike in the US, where pension funds are relatively free in their investment behavior, the way in which Japanese fund managers can invest pension capital is limited to stocks, bonds, cash deposits, and real estate (see above). Furthermore, the MoF's practice of 'guiding' the investments of life insurance companies has contributed to poor pension fund performance as well. While in the 1950s and 1960s the MoF guided EPF investments into targeted sectors (especially electricity, steel, coal, and shipbuilding) and into public housing (more than 40 percent of all loans were granted upon governmental request; Estevez-Abe 1997: 11), in the 1990s, life insurance companies were regularly urged by the MoF to invest into the Tokyo Stock Exchange when very few institutional investors were willing to enter the sluggish Japanese market (cf. Murdo 1993: 14). The MoF also used the capital of Postal Savings and of the Employee Pension System for these 'price-keeping operations' without showing much concern for the poor returns resulting from these interventions. With respect to the political influence exerted on the investment behavior of Employee Pension Funds, one may even speak of the Japanese government's 'third budget' besides the FILP and the official 'first' budget (cf. Estevez-Abe 2001).

Moreover, pension fund assets were valued at their historic costs rather than at the actual market value. While this helped fund managers conceal losses caused by the enormous fall in asset prices in the early 1990s, it also inflated the value of the shares held in the portfolio since many stocks had been bought during the stock market 'bubble' of the 1980s. This meant that pension fund managers could not invest in the stock market when prices were low since their overvalued old portfolio already bumped up against the maximum 30 percent ceiling that regulators allow fund managers to invest in stock. Fund managers also had problems to sell poorly performing blue chips in order to invest into more dynamic industries or new firms, since this would have meant to acknowledge undeclared losses incurred since the 1980s and would have forced firms to raise pension contributions, a step that all involved, fund managers as well as companies, wanted to avoid. Thus, capital remained trapped in the old firms. [22] What is more, the low interest rate policy employed by the government to stimulate economic recovery also reduced the interest paid on bonds and thus further depressed pension fund performance. For instance, average revenue from pension fund assets had been at 5.74 percent in 1997. In the financial year 1998, investment return for the overall pension funds dived to 2.49 percent sending the pension funds into the worst fiscal condition since the Kosei Nenkin Kikin fund system was introduced in 1966 (Jiji Press, April 14, 2000). Many firms had to register negative pension fund yield. Due to a strong increase in stock prices, the return of pension funds in 1999 was much better, but the recent drop of the Nikkei index again puts pension funds and life insurance companies under serious stress. Because of the sharp reduction in asset prices after the burst of the bubble economy, the annual average yield of Japanese pension funds calculated from 1984 to 1996 was practically zero, compared with an annual return of 9 percent in the United States over the same period (EU 1999: 45, Appendix 2; cf. Suto 2000: 18, Fn. 14). US-American pension funds not only produced a much higher yield, but often were so profitable that revenues overcompensated the company payments set aside for pensions, thus contributing positively to consolidated corporate earnings (Clark et al. 2000: 8-9). Owing to the negative yield gap, i.e. the low return from pension assets but high guaranteed insurance premiums for the insured, seven Japanese life insurance companies have already been forced out of business (Nissan Mutual [1997], Toho Mutual [1999], Taisho Life, Dai-hyaku Mutual, Chiyoda Mutual and Kyoei [2000; the insolvency of Kyoei Life with a debt of 4.53 trillion Yen was as yet the largest insolvency in Japan's postwar history], Tokyo Mutual Life [2001]; see Probert 2001: 5 and FAZ 24.03.2001). A similar trend can be observed for pension funds themselves. The number of dissolved funds has steeply increased since the second half of the 1990s (starting with one dissolved fund in 1994, one in 1995, seven in 1996, fourteen in 1997, eighteen in 1998 and twenty-three in 1999; Suto 2000: 22, Table 7, and Japan Economic Newswire, 13 May 2000).

The increasing maturity of the existing public and private pension schemes and the unfavorable demographic trends are, of course, the most salient factors that have rendered the status quo increasingly unattractive. The trade-off between an interest in good performance of pension funds and in upholding the traditional stable shareholding relations thus has become more costly.

Yet, the political measures taken in response to these growing problems since the mid-1980s reacted primarily to external pressures (Higachi/Lauter 1990: 268-269). Since the early 1980s the 'domestic market outsiders', Japanese securities firms, combined forces with 'foreign outsiders', in particular U.S. banks, and "pressured the Ministry of Finance to deregulate" the pension market (ibid.: 268). Deregulation of the Japanese pension market then became a prominent topic in the U.S./Japan trade negotiations in 1983-84 headed by finance Minister N. Takeshita and Secretary of the Treasury D. Regan. Against considerable resistance of the domestic banking and insurance sector the MoF finally aggreed to the admission of foreign banks to the pension market - either alone or in cooperation with Japanese trust banks. "Not to be left out, securities firms and other foreign institutions created investment advisory companies to interact with the pension fund market" (ibid. 269). These advisory firms were granted market access starting in 1990. This marked the beginning of the opening up of the Japanese pension market - a process that has accelerated considerably over the course of the 1990s.

Several domestic trends have fuelled this development. Because the 'silent shareholders' in the past have not claimed a large share of corporate profits, many firms were able to accumulate their own internal capital, which now finances their investments. There is clear indication that the role of banks as the main provider of investment capital for companies has been in steady decline since the 1980s and that Japanese firms today are no more dependent on bank debt than US-American companies (Yafeh 2000: 79, Table 1). A similar if perhaps less spectacular trend seems to hold true for the traditional stable shareholding arrangements (see Fn. 21). Also the booming stock market in the 1980s made it easier for firms to resort to equity finance and to invest their internal funds into stocks or to issue bonds to raise capital. Moreover, an increasing number of Japanese firms now have overseas operations and prefers to raise capital in local currencies to eliminate exchange risks.

Given that 'equity finance' has gained in importance over 'debt finance' and that an increasing number of Japanese firms are internationally listed, American accounting standards have become more important for Japanese firms as well. Especially in keeping with the No. 87 US Federal Accounting Standards, Japanese firms have begun to disclose their pension fund deficits (Miyake 1998: 2). This, in turn, adds more pressure to quickly improve pension fund performance and to substitute defined contribution schemes for the traditional defined benefit schemes. This is only one among several reasons why especially US-American and British investment houses were successful in expanding their market shares in the huge Japanese pension fund market lately. Starting from zero in 1990 when the deregulation of the Japanese pension market began, the market share of pension managers other than the traditional life insurance companies and trust banks had reached 14 percent by the end of 1998, and especially foreign companies have benefited from this trend because of their better performance (Pensions & Investments 1998, Nov.: 16). In 1998, foreign companies already held 30 percent of the investment advisory business. An increase in the number of business partnerships between foreign and Japanese asset managers (e.g. Dresdner Kleinwort Benson with Meiji-Life Insurance, Putnam with Nippon Life, and Alliance Capital with Sumito Trust) is just another indication of the profound changes within the pension fund market toward a much more performance-oriented Anglo-American model of corporate finance and governance. Another opportunity for market entry by foreign firms has been the numerous bankruptcies that have occurred recently among Japanese life insurer (see above). [23] A corresponding 'internationalization' of the pension business results because Japanese trust banks and life insurance companies are pressured to increase their holding of foreign stocks (after the tight MoF-regulation with respect to their portfolio composition has been abolished). The revenue on domestic stock and assets nowadays is too poor to even meet the moderate 5.5 percent return target traditionally set by the Ministry of Finance. This forces "Japanese financial institutions to direct their investment to where it can achieve the highest returns, not simply to outdated *keiretsu*-partners" (Katz 1999: 98).

The reform of the Japanese pension system has proceeded so far in a piecemeal fashion. However, liberalization accelerated over the course of the 1990s, and today the various steps add up to a quite significant change. To name but a few of these reforms: In the Fiscal Year (FY) 1990 foreign banks and investment advisory companies were allowed to compete for the administration of newly founded pension funds as one of the measures agreed upon in the U.S./Japan trade negotiations in the mid-1980s. Market entry was extended for foreign insurance companies in the wake of the US/Japan Structural Impediment Initiative in 1991-2 until the market was being completely opened for foreign investment firms due to the US-Japan Financial Services Agreement in 1995. In FY 1996 the 5-3-3-2 rule was revised, in 1998 the rule was abolished altogether. The year 1997 saw the introduction of segmented accounting and the introduction of market-value accounting. Pension funds were allowed to set independently expected pension fund yield on the basis of the maturity and risk of the fund. Starting in 1996, companies with funds with capital above 50 million Yen were allowed to administer their funds internally; since June 2000, this rule has been extended to smaller funds as well, and the provision that restricted investments of these in-house funds solely to domestic government bonds was abolished. In October 1999, the Pension Fund Association (PFA) allowed fund managers to put money into 'alternative investments' including derivatives, venture capital- or buyout-vehicles or hedge funds. It has also issued guidelines urging trust banks and life insurance companies to exercise their voting rights at shareholder meetings "in consideration of the investment returns to pension funds". Next reform steps will include the deregulation of Tax Qualified Pensions holding assets of about 22 trillion Yen (about $180 billion) as of 1998. Moreover, postal savings and pension fund capital will not be administered anymore by the Trust Fund Bureau of the MoF. Since FY 2000, new accounting standards force Japanese firms to declare all their retirement liabilities on their balance sheets in accordance with US Generally Accepted Accounting Principles (GAAP). Nonfunded pension liabilities will have to be amortized within the next fifteen years starting from FY 2000. The Japanese diet passed a law in early 2000 permitting firms to set up 401(k)-style pensions schemes, although tax incentives in support of these new defined contribution schemes are not as favorable as in the US. [24]

This incomplete list of reforms of the Japanese pension system indicates that the general trend in the Japanese private pension market clearly goes in the direction of the Anglo-American shareholder model of corporate governance. This has already provoked calls to legislate a Japanese equivalent to the US Employee Retirement Income Security Act (ERISA) since the old guarantees for the security of pension entitlements that were based on inter-firm coordination and stable shareholding seem to quickly evaporate. While these reforms will certainly make the Japanese pension sector much more effective and will yield higher returns on pension capital, they will also undermine the old practices of cross-shareholding and the role of life insurance companies and trust banks as patient and silent providers of long-term credit to Japanese firms, which will have important consequences for the Japanese stakeholder model of corporate governance.

4 Summary

In this paper I have argued that the systems of social protection have played an often ignored, yet very important role in the coordinated political economies of Germany and

Japan. They were critical for upholding long-term economic coordination between capital and labor, and this coordination lay at the heart of the stunning economic success of both countries in the first three postwar decades (Eichengreen 1994). Particularly the pension systems of the two countries, dissimilar as they are, have provided firms with patient capital and have allowed firms to credibly commit themselves to the promise to reinvest profits in exchange for workers wage moderation, thus setting the German and Japanese economy on a spectacular high growth, high productivity trajectory in the 1950s and 1960s. In various additional ways, both the public German and the private but tightly regulated Japanese pension system have allowed firms and workers to enter into long-term economic coordination: the pension systems supported long job tenure through seniority related benefits (Oshio/Yashiro 1997), offered complete status protection in case of dismissals, were obviously able to alleviate union collective action problems posed by wage moderation by securing intergenerational fairness, and provided workers with incentives to invest in industry-specific and/or firm-specific skills (cf. Estevez-Abe et al. 1999).

Today's crisis of both models of economic coordination has spilled over into the welfare state and appears here in form of a financial crisis. As has been shown in the preceding sections, the political attempts to tackle this financial crisis, in turn, have profound feedback-effects on the traditional, non-liberal forms of corporate finance and governance in Germany and Japan exactly because 'protection' and 'production' were so intimately intertwined in both postwar economies. All the available evidence on the direction of the recent welfare- and, more specifically, pension-reforms suggests that these reforms will not counteract, but will contribute, mostly *deliberately* contribute to the further erosion of the traditional business practices in Germany and Japan. Both countries have, albeit to different degrees, begun to embrace "pension fund capitalism" (Clark 2000) Anglo-American style. Yet, we should not necessarily expect simple convergence on the Anglo-American model. In Germany, the establishment and administration of company pensions falls under the co-determination law. Hence, the increased importance of pension funds due to the 2001 pension reform may also prove advantageous for the German unions. In Japan, the dissolution of the old inter-company ties and the conversion of the life insurance companies and 'investment advisors' into revenue-maximizing institutional investors may result in a "fusion between a market-based system and a relationship-oriented system" of corporate finance (Suto 2000: 33) rather than lead to a simple copy of the American model, given that pension funds themselves still cannot exercise their shareholder rights and investment decisions directly but remain dependent on financial intermediaries (ibid.). Despite these retarding moments, we can clearly trace a process of fundamental change in German and Japanese corporate finance. The established practices of economic coordination in both countries have become endangered species within a new economic environment that has put them at an evolutionary disadvantage.

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Endnotes

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1 Market capitalization of publicly quoted domestic companies in percent of GDP, 1985

	US	UK	Japan	Germany
Gross	51	90	71	29
Net CrossHoldings	48	81	37	14
Source: Wenger/Kaserer (1998: 505).				

2 'Defined benefit' pensions (DB) represent a *fixed* 'payment promise,' they define the amount paid out, i.e. the benefit (like $500 monthly or 70 % of the last wage), while 'defined contribution' pensions (DC) only define the amount paid in. Pension entitlements then depend on how these contributions have been invested. In the DB case, the entire risk remains with the side that grants the pension; in the DC case, the risk is borne entirely by the side that receives the pension payment.

3 Following the general hypothesis that there "seems to be a strong interdependence between the size, the strength and importance of national equity markets and the national old-age systems" (Hauck 1994: 556).

4 Again, the high tax level in postwar West Germany was due to the felt need to massively invest into housing, infrastructure, etc. and to restrict consumption (see Shonfield 1965: 265-269). Moreover, the German Ministry of Finance systematically underestimated the rate of growth and consequentially the overall tax revenue.

5 In this context it is important to note that even the Nazis had substantially curtailed the importance of the stock market in the wake of the war economy; (cf. Boelke 1985).

6 Stocks accounted for only about 1.9 % of all private investments in 1949 and 1950, while

retained profits and short-term credit accounted for about 70 % in 1949 and 53.4 % in 1950 (Adamsen 1981: 257).

7 Since the German pension insurance was much more mature than the Japanese Employee Pension System, the misuse of its capital for war financing had much more devastating consequences (Manow 1997; Boelke 1985). While war financing was one of the prime goals that had stood behind the establishment of the Japanese EPS as well (cf. Collick 1988: 210), the level of contributions and the amount of accumulated capital in the EPS paled when compared to the German pension schemes.

8 The blue-collar and white-collar old-age insurance funds were mandated to invest at least a quarter of their capital assets in government securities.

9 Shonfield simply erred when he wrote that "German social security funds have a quite unusual freedom in the conduct of their investment policy" (Shonfield 1965: 270).

10 Employers' freedom in the design of company pension schemes was further restricted in 1989 by the European Court of Justice that ruled against exclusive eligibility to company pensions for the long-term and full-time (i.e. predominantly male) employed in the name of women's equal workplace rights (Tegtmeier 1992).

11 Since 1974, entitlements were vested after ten years (before only after fifteen years). The 2001 reform will require only five years.

12 The contribution rate had been stable at 14 % for the first ten years after the major 1957 pension reform.

13 Defined benefit *private* pension schemes as well as wage-indexed *public* pensions surmount "problems of intergenerational equity" between different cohorts of workers in the case of wage coordination/wage moderation (Eichengreen 1994: 49). "Wage moderation now which translated into higher incomes later might benefit future generations at the expense of present ones, a fact which might cause those currently working to hesitate to defer their gratification. Governments therefore indexed pensions not just to changes in the cost of living, but to increases in the living standards of the currently employed" (ibid.).

14 Unions and large German employers like *Volkswagen* have already declared that they will establish defined contribution pension funds. At the same time, the association of German mechanical engineering firms (VDMA) complains about the retreat of banks from the traditional credit business. The predominantly small- and medium-sized firms in this sector are mostly not listed, have a thin capital stock, and act in a volatile environment. They therefore depend on long-term, 'patient' credit.

15 For the small firms outside the EPF system, this was still an option and the "popularity of book reserve plans in Japan [among small firms; P.M.] despite of their unfavourable tax treatment indicates the high value that firms appear to place on the availability of this form of corporate financing" (Turner/Watanabe 1995: 57).

16 In terms of comparative market penetration, foreign insurers in major European markets hold a much higher percentage than foreign insurers in Japan, e.g., in 1996, 13% in France, 33% in Italy, and 19% in the UK. Foreign insurers in Japan have about 2.7% (EU 1997).

17 While the anti-monopoly law as of 1947 ruled that firms are not allowed to own more

than 5 % of a firm's stock and life- insurance companies no more than 10 %, these restrictions do not seem to have been generally binding.

18 Only four of the twenty Japanese life insurance companies are joint stock companies. These four firms are rather small in size and have much lower economic importance than the mutual companies (Komiya 1994: 366-367, 379).

19 Minimum: 50 % bonds and loans; maximum: 30 % equity, 30 % foreign denominated assets, 20 % property/real estate.

20 According to one estimation, 44 % of all equities were part of stable shareholding arrangements around 1980, 51 % around 1990 ? a number which has declined today to an estimated 40 % (FAZ 2001 January 16., p. 29). Suto (2000: 14, Table 3) reports the following data: 41.1 % of all shares in 1990 were part of stable shareholding arrangements, but only 35.7 % in 1997. Of course these numbers have to be interpreted with caution.

21 In Germany, company pensions in the form of book reserves represented the promise that profits would remain within the firm, in Japan the 'functional equivalent' was the contracting out of pension funds to a life insurer or trust bank in exchange for the purchase of shares of the contracting company by a fund-managing firm.

22 To put it the other way around: stable shareholding or bank finance and bank-dominated corporate governance are apparently "suitable for the financing of 'traditional' manufacturing industries, but [are] not appropriate for financing innovation. When the technology is novel and unknown, a large and liquid stock market with a 'diversity of opinions' is required to evaluate future prospects" (Yafeh 2000: 80).

23 See the following takeovers or merges among 'unequals' AXA - Nippon Dantai; Aetna - Heiwa; GE Edison - Toho; Manulife - Dai-hyaku; Artemis - Aoba Life.; AIG - Nissan Mutual Chiyoda; Prudential - Kyoei; Winterthur - Nicos Life; etc. (see Probert 2001: 5, Fn. 5).

24 With the increasing number of mergers, hostile takeovers and bankruptcies, the risk of 'defined benefit'-schemes have increased, which makes the investment risks in 'defined contribution'-schemes look less serious. In FY 1999, of the twenty-three pension funds that were discontinued, seven were suspended because of corporate mergers (Japan Economic Newswire, 13 May 2000).

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